



HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Supervision Department

銀行政策部

Our Ref.: B4/1C & B9/128C

14 August 2014

Mr He Guangbei
Chairman
The Hong Kong Association of Banks
Room 525, 5/F,
Prince's Building
Central
Hong Kong

By email & by hand

Dear Mr He,

Consultation on Supervisory Policy Manual (SPM)
“Approach to Implementing the Countercyclical Capital Buffer (CCyB)”

I am writing to seek the Association's comments on a draft SPM module on the “Approach to Implementing the Countercyclical Capital Buffer (CCyB)”, which will be issued by the HKMA as a non-statutory guideline following industry consultation.

As the Basel Committee has observed, the losses incurred in the banking sector during a downturn, which has been preceded by a period of excess credit growth, can be extremely large. These losses can destabilise the banking sector and effectively spark a vicious circle. In an endeavour to address these issues, the Basel Committee has developed a series of measures to help ensure that the banking sector serves as a “shock absorber”, instead of a transmitter or amplifier of risk to the financial system and the broader economy.

One of these measures is the Basel III Countercyclical Capital Buffer (CCyB). This draft SPM module aims to explain the MA's approach towards implementing the CCyB as part of the capital adequacy framework for AIs incorporated in Hong Kong. This module is intended to complement AIs' understanding of the relevant parts of the Banking (Capital) Rules (BCR) as amended by the proposed Banking (Capital) (Amendment) Rules 2014 (BCAR 2014) and of the Banking (Disclosure) Rules as amended by the proposed Banking (Disclosure) (Amendment) Rules 2014 (BDAR 2014), but should not be read as in any sense substituting or amending the text of the BCR or BDR. The draft BCAR 2014 and BDAR 2014 are being consulted on separately. The module covers mainly the following topics:

- (i) **Overview of the CCyB Framework** – in Sections 1 and 2, the module provides an overview of the CCyB's policy objectives and of the rules referring to the CCyB in the BCR and BDR, i.e the CCyB as an extension of the Capital

Conservation Buffer (CCB), the calculation of the AI-specific CCyB rate as the weighted average of the applicable jurisdictional CCyB rates, the time provided for AIs to adjust their capital between the announcement of a jurisdictional CCyB rate and its becoming effective (pre-announcement period) and the relevant reporting and disclosure requirements.

(ii) **The MA’s approach to determining and announcing the Hong Kong jurisdictional CCyB rate** – in Section 3, the module explains the MA’s “guided discretion” approach to determining and announcing the Hong Kong jurisdictional CCyB rate:

- The approach takes as its starting point the CCyB rate resulting from an “Initial Reference Calculator” (capped at 2.5% of RWA and subject to the phase-in schedule provided by the Basel Committee for the period 2016-2019) that is transparently calculated and made public. The Initial Reference Calculator’s CCyB rate guide is the lower of two guides: (i) a Composite CCyB Guide based on a credit/GDP gap and a property price/rent gap, which reflect increasing or decreasing signs of excessive credit growth and/or property prices; and (ii) an Indicative CCyB Ceiling based on an interbank risk spread and a loan quality indicator, which can provide an early signal of significant stress in the banking system that could lead to excessive credit constraint if the CCyB is not released in a timely manner.
- The decision process then builds upon the Initial Reference Calculator by incorporating the analysis of information from a broader set of “Comprehensive Reference Indicators” and other appropriate sources. The final policy decision will then be taken on the basis of informed judgement and will be publicly communicated, with a reasoned justification when the decision departs from the guide provided by the Initial Reference Calculator in either a “tightening” or “loosening” direction. As provided under the draft BCAR 2014, any decision to accelerate the phase-in of the Hong Kong CCyB rate or to set it above 2.5% will be subject to specific consultation with the industry.

(iii) **The MA’s approach to recognizing overseas CCyB rates** – in Section 4, the module explains the MA’s approach to implementing the Basel Committee’s standards on jurisdictional reciprocity, as incorporated into the draft BCAR 2014. This approach can be summarized as follows:

- Absent any notification by the MA indicating otherwise, AIs should adopt, for the purposes of determining the applicable jurisdictional CCyB rate in respect of a jurisdiction outside Hong Kong, the level of the jurisdictional CCyB rate and the date for its becoming effective as announced by the relevant authority of the respective jurisdiction, except that: (i) AIs are not required to adopt an applicable jurisdictional CCyB rate of more than 2.5%; (ii) if the pre-announcement period is less than 6 months, AIs may adopt an effective date falling 6 months after the date of the announcement by the relevant authority concerned; and (iii) if the pre-announcement period is more than 12 months, AIs must instead adopt an effective date falling not more than 12 months after the date of the announcement by the relevant authority concerned.

- Notwithstanding the above, the MA may (i) where a jurisdiction sets a jurisdictional CCyB rate below 2.5%, require AIs to adopt a higher rate (but not higher than 2.5%) or (ii) where a jurisdiction sets a jurisdictional CCyB rate above 2.5%, require AIs to adopt the rate set by the jurisdiction concerned, in each case in the circumstances set out in the draft BCAR 2014. The MA may also specify a different effective date from that set by the relevant jurisdiction, in the circumstances set out in the draft BCAR 2014, but if the applicable jurisdictional CCyB rate is increasing, the effective date must not be less than 6 months nor more than 12 months from the date of announcement of the CCyB rate. Section 4 describes the criteria to which the MA proposes to have regard when exercising the discretion provided above.

I would be grateful if the Association's comments on the draft module could reach us by 14 October 2014. Should you have any questions regarding the enclosed draft module, please feel free to contact Mr Noel Sacasa (njsacasa@hkma.gov.hk) or Mr Rocco Huang (rrhuang@hkma.gov.hk).

I am writing in similar terms to The DTC Association.

Yours sincerely,

Karen Kemp
Executive Director (Banking Policy)

Encl.

c.c. FSTB (Attn. Mr Jackie Liu)